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OFFICIAL FILE
I.C.C. DOCKET NO. 02-0479
CACC Exhibit No. 23
Witness
Date 9/16/02 Reporter

May 3, 2002

The Honorable Lisa Madigan
Illinois State Senator
105C Statehouse
Springfield, IL 62706

Dear Senator Madigan:

I want to provide you some background materials on Senate Bill 2081 – the proposal to extend for 2 years the transition period set out in the Illinois Electric Service Customer Choice and Rate Relief Act of 1997. On May 2, this bill received 112 Yes votes (with only 2 No) and now awaits concurrence in your chamber. The proposed bill would extend the rate freeze now in effect for an additional two years (2005-06), extend the Law's strong labor protections; and extend the earnings sharing protections while prohibiting utilities from passing along higher fuel prices to consumers through 2006.

We responded to claims made by the Illinois Commerce Commission Staff through House chamber discussion on this bill, and would like to summarize that dialogue for you. Commission Staff argued that this rate freeze extension might generate benefits for utilities and the implicit assumption that legislation could not generate both consumer benefits and be palatable to utilities. We disagree with that proposition and elaborate below.

That the General Assembly's 1997 Illinois Rate Relief law has conferred significant benefit on consumers is undisputed. In ComEd's service territory, rates for commercial and industrial consumers have been frozen at levels set in 1995. Residential consumers have received a 20% reduction off those rates – and are now paying less for electricity than they paid in 1990. Northern Illinois consumers are expected to save roughly $2.8 Billion through 2004, and an additional $1 Billion through 2006 (compared to their 1997 bills) as a result of the rate reduction and freeze. In fact, ComEd now has some of the lowest energy rates of any major metropolitan area -- and rates that compare favorably to Wisconsin. (See chart attached).

The question presented by this bill is whether freezing rates at levels equal to 1990 rates will continue to generate consumer benefits 9 and 10 years after they were set – in 2005 and 2006. We believe the answer is clear. Under an extended rate freeze, customers would pay today's low bundled rate through 2006 regardless of market conditions. If wholesale market prices go up customers can purchase current bundled rates. If wholesale market prices turn out to be low, residential customers will have the opportunity to benefit by switching to an alternative supplier which, due in part to a mitigation factor or "shopping credit" of 6% off the bundled rate and increasing to 10% in 2006, will be situated to "beat" the utility price. While future prices cannot be predicted with certainty (and if they could, we would not be involved in this debate), there is widespread agreement that prices in energy markets are volatile. Absent a price freeze, customers will be exposed to this volatility. The table below shows potential ComEd bundled rates in 2005 across a range of wholesale market prices. Based on this plausible range of prices, rates could go down by roughly 5% or up by as much as 60%.

Potential 2005 Residential Rates (cents per kWh)

	Low Market Prices (2002 Illinois)	Moderate Market Prices (2001 Illinois)	High Market Prices (2001 Massachusetts)
Market-Based Bundled Rate[1]			
Delivery Service	3.8	3.8	3.8
Transition Charge	1.2	0.0	0.0
Market Value + 10%	3.0	5.4	9.6
Total	8.0	9.2	13.4
Current Bundled Rate	8.4	8.4	8.4
2005 Rate Increase/Decrease	-5%	+10%	+60%

To those that say that high market prices are extremely unlikely, past evidence from both gas and electric markets suggests otherwise. The high market price scenario is not an extreme case by any means – it is based on 2001 residential energy prices in Massachusetts that were determined through a competitive RFP for 6-month supply. More extreme cases have occurred – California load shaped prices exceeded 20 cents per kWh in December 2000. Here in Illinois, wholesale prices climbed to $2.60 per kWh for a brief period in summer, 1998.

There is an additional benefit to an extended transition period. Currently, Illinois is one of the few jurisdictions where electricity restructuring is still moving forward. This is so in large part because the General Assembly planned for a phased-in, gradual transition period. This transition period has allowed the stakeholders to adjust market mechanisms as need be to accommodate the twists and turns in the restructuring path that no one could have predicted. Even with this advantage, competition has developed more slowly in some consumer classes than anticipated. The additional two years of transition would be beneficial to market development, particularly to develop "Provider of Last Resort" rules so that residential, low income and other markets with less than robust activity can be provided with certainty.

[1] Assumes bundled rates subsequent to the mandatory transition period are set as suggested in the current Law: Delivery Service Charges + Transition Charges + (Market Value + 10%).

Commission Staff focused solely on the potential that this bill could generate benefits for utilities. Commission Staff asserted this bill will create a "windfall" for ComEd and other utilities of the magnitude of several billion dollars. Commission Staff posited various theories under which such a "windfall" might materialize, but none hold up under scrutiny.

Commission Staff also raised FERC issues, specifically the possibility of cost-based rates, as reason for rejecting SB 2081. These concerns are not well founded. FERC's overiding policy goal is the creation of well functioning competitive wholesale markets, not a return to cost-based rates. FERC's top priority for achieving this goal is the formation of Regional Transmission Organizations (RTOs). FERC has made clear that it will be easier for suppliers to gain approval for market based rates within the context of an RTO. The only issue still being debated within the FERC is whether market-based rates should be routinely approved within any operational RTO or whether routine approvals should be reserved for those RTOs that have implemented "standard markets."

The so-called Supply Margin Assessment (SMA) test that was proposed by FERC last year as a new measure of market power would apply only to non-ISO or non-RTO markets. It appears that FERC is utilizing this test as an incentive for utilities to form RTOs. It is a virtual certainty that ComEd will be a member of an approved RTO within a year; making SMA discussions or any discussions of a move to cost-based rates – and presumed reduced wholesale market prices – irrelevant.

That leaves a final question. Ignoring the Commission's claims of multi-billion dollar benefits, does this bill provide benefits to utilities? ComEd believes it does, but that it also poses risk. The key benefit of this freeze is certainty. A two year extension of the rate freeze enacted now would allow ComEd an adequate planning horizon to develop a portfolio capable of serving its load. ComEd will continue to be challenged by planning for uncertain load at a fixed price – we can estimate, but cannot predict with certainty, how many customers will require utility service at any point in time. We also assume the risk of wholesale market price volatility. These are significant risks to the utility. Nonetheless, knowing the rate at which it must serve will provide one aspect of certainty as we move through the transition period. We believe we can manage that risk with the time horizon allotted and through our portfolio management skills.

Thank you. As always, should you have any additional questions, please feel to contact me.

Sincerely,

John T. Hooker

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cc: Senate Environment & Energy Committee Members
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